



City of Richmond

Report to Committee

To: Finance Committee

Date: December 10, 2009

From: Katherine Lecy
Manager, Payroll & Accounts Payable

File: 03-0900-01/2009-Vol
01

Re: **Impact of Harmonized Sales Tax (HST) to the City**

Staff Recommendation

That this report from the Manager, Payroll & Accounts Payable on the impact of the Harmonized Sales Tax to the City be received for information.

Andrew Nazareth
General Manager – Business and Financial Services
(604-276-4095)

Att. 1

| FOR ORIGINATING DEPARTMENT USE ONLY | | | | | |
|--|--|---------------------------------------|-----------------------------------|--|--------------------------------|
| ROUTED TO: | CONCURRENCE | | CONCURRENCE OF GENERAL MANAGER | | |
| Enterprise Services Unit (Economic Development) | Y | <input checked="" type="checkbox"/> N | | | |
| REVIEWED BY TAG | YES <input checked="" type="checkbox"/> <i>MR</i> | NO <input type="checkbox"/> | REVIEWED BY CAO DEPUTY | YES <input checked="" type="checkbox"/> <i>MR</i> | NO <input type="checkbox"/> |

Staff Report

Origin

The Province of BC announced that it would harmonize the Provincial Sales Tax (PST) and the Federal Goods and Services Tax (GST) into a 12% Harmonized Sales Tax (HST) effective on July 1, 2010.

The new HST will be applied based on the rules for the GST meaning that a much broader range of goods and services will be subject to provincial sales tax than under the separate tax programs. There are a number of initiatives to partially offset the broader based tax including an increase in the basic personal tax credit and the introduction of a new low income tax credit.

A partial rebate of the provincial portion of the HST for local governments was announced. Specifically, the Province of BC will provide a rebate of 75% on the provincial portion of the HST for local governments that qualify for the federal municipal GST rebates. The municipality will receive a rebate on 75% on the 7% PST portion and 100% on the 5% GST portion. This results in an overall effective rebate of 85.4% of the HST. The intention of the rebates for the provincial portion of the HST will, on average, ensure that local governments will not pay any more provincial HST after harmonization than they currently pay in PST.

Analysis

At a glance there appears to be an increased cost; however, the Province of BC advises that the benefits of the harmonized sales tax will make BC businesses more competitive, improve productivity, reduce administrative costs, encourage new investment and job creation to generate long-term economic growth.

The Province of BC anticipates the elimination of embedded PST in products. Under the current system, taxes are paid in every step in production and passed on to consumers. In some cases earlier taxes may have been compounded by applying tax upon tax before ultimately being taxed one last time when purchased by the consumer. This process is commonly referred as tax cascading.

Under the proposed HST system, businesses can claim a tax credit for much of the HST they pay on non labour inputs, effectively reducing the tax being paid on the final sale of goods and services. The embedded tax cascading costs are removed and savings will be passed on to the consumer/municipality. In a report produced by Toronto Dominion Economics, "*The Impact of Sales Tax Harmonization in Ontario and BC On Canadian Inflation*", economists estimate that the move to a harmonized tax will reduce the cost of doing business by a total of \$6.9 billion in Ontario and BC. As such, consumers in BC and Ontario could witness a 0.8-0.9% drop in pre-ticket price in the purchase of goods and services.

The move to HST is not uncharted territory as other regions and countries have also gone through the experience. A study for the C.D. Howe Institute found prices in the Atlantic provinces generally fell by 0.3%, while some large items fell as much as 3%. The same happened when the GST first

came in, as a replacement for the old Manufacturers Sales Tax (MST). In 1989-90, the MST was 15.3% of federal revenues, or about 2.7% of GDP. In 2005-06, the last full year before the federal government began cutting the GST, the tax yielded 14.9% of federal revenues; as a share of GDP, it was also down to 2.4%.

The impact on consumers will vary depending on personal and family circumstances and spending patterns. Consumers who buy mainly goods that currently has both PST & GST will see no change in their taxes payable but a person who consumes a lot of services will pay more with HST. A list of goods and services affected by harmonization is attached as Appendix A. To offset the impact to HST to individuals, the Province of BC will provide a new low income tax credit, increasing the basic personal amount from \$9,373 to \$11,000, and providing relief for the provincial portion of HST payable on residential energy.

HST impact to the City of Richmond

Additional Hotel Room Tax (AHRT)

Currently hotel rooms are charged 5% PST, 5% GST, and 5% AHRT (which consists of 3% to fund Tourism BC and 2% for local tourism development). The 5% PST and 3% AHRT (Tourism BC) will be replaced with the 7% provincial portion of HST. Effective July 1st, 2010 the 15% in taxes will become 14% (12% HST plus 2% AHRT).

The remaining 2% additional hotel room tax will be repealed July 1st, 2011. The province will consult with all stakeholders regarding the future of this program. Affected municipalities have indicated the importance of the additional hotel room tax for funding tourism development at the local level. The UBCM has been working with the Ministry of Finance to ensure the AHRT is retained in a manner to support the goals of local tourism development, including destination marketing and long-term strategic destination management.

Municipal Services

A number of municipal services related to property tax are exempt from GST such as water and sewer use, garbage collection, business and animal licenses, building permits, DCCs and zoning application fees. These will continue to be exempt of HST and there will be no impact to a resident.

Municipal revenues that attract GST will now increase from 5% to 12%. Fees that are taxable include facility rentals, park rentals, advertising, sale of memorabilia, street occupancy permits, street and lot parking, and a number of recreational programs.

Community and Oval recreational and fitness programs will be required to charge HST. Fitness programs for children under 15 will remain exempt from GST/HST. Recreational services provided primarily to underprivileged individuals, or individuals with a disability, are also exempt.

Filming revenues relating to commercial filming application, street occupancy permits, cost recovery fees such as traffic management and RCMP services will attract the 12% HST. The film

industry is extremely mobile with fluctuations in foreign exchange as well provincial/state tax incentives. The 7% increase will be another factor in their decision to whether or not to film in the City of Richmond.

As mentioned previously, GST/HST applies to street and lot parking. Three municipal parking lots also attract PST. Effective January 1, 2010, PST on the purchase price of parking rights will increase from 7% to 21% as set by the South Coast British Columbia Transportation Authority (Translink). Unfortunately, the 21% rate exceeds the general sales tax rate threshold specified in the GST/HST regulations, which would exclude the PST from GST/HST. As a result, the 21% PST is subject to GST thereby making the effective combined tax rate 27.05% on January 1st, 2010 and 35.52% effective July 1st, 2010. Revenues from Brighthouse, Gateway Theatre/Minoru Chapel, and Bowling Green generate approximately \$62,000.

To understand the impact of HST on operating and capital expenses for the City of Richmond, an analysis between the mix of purchase of services (GST only) and goods (both PST and GST) must be understood.

To illustrate the impact, a comparison must be made between both types of purchases as shown below:

| | PST + GST | HST 75% on 7% & 100% on 5% | |
|-------------------------------|---------------------|---|-----------------------------|
| 1. Consulting Services | | | |
| Taxable Land Purchases | | | |
| (PST Exempt) | \$100,000.00 | \$ 100,000.00 | |
| PST | \$ - | \$ - | |
| GST/HST | <u>\$ 5,000.00</u> | <u>\$ 12,000.00</u> | |
| Total Contract | <u>\$105,000.00</u> | <u>\$ 112,000.00</u> | |
| GST/HST Rebate | <u>-\$ 5,000.00</u> | <u>-\$ 10,250.00</u> | 85.4% Rebate |
| Cost to City | <u>\$100,000.00</u> | <u>\$ 101,750.00</u> | \$ 1,750.00 Increased Cost |
| 2. Paper Purchase | | | |
| (PST Payable) | \$100,000.00 | \$ 100,000.00 | |
| PST | \$ 7,000.00 | \$ - | |
| GST/HST | <u>\$ 5,000.00</u> | <u>\$ 12,000.00</u> | |
| Total Contract | <u>\$112,000.00</u> | <u>\$ 112,000.00</u> | |
| GST/HST Rebate | <u>-\$ 5,000.00</u> | <u>-\$ 10,250.00</u> | 85.4% Rebate |
| Cost to City | <u>\$107,000.00</u> | <u>\$ 101,750.00</u> | -\$ 5,250.00 Decreased Cost |

On an annual basis, Accounts Payable will process \$220 million in payments (both operating expenses and capital programs). Approximately 55% of these transactions are services with GST only; 10% are for goods with GST + PST; and 35% are federal or provincial payments, grants or levies that do not attract GST. The transactions result in:

- Operating expenses will attract 12% HST or \$9 million;
- Rebate of 75% on 7% and 100% on 5% results in an overall rebate of 85.4% or \$7.7 million;
- Unrecoverable HST is \$1.3 million less the \$1.1 million that would have been paid in PST;
- Expected costs savings on BC produced or assembled goods due to the removal of embedded tax has not been factored into this analysis.

With respect to the capital programs, over 90% of spending attracts GST only. These include tendered contracts and taxable land transactions for exempt use such a creation of a park. There will be initial increases due to the unrecoverable HST offset by savings on equipment purchases. On taxable land transactions for exempt use, implementation of HST will result in a 1.75% increase which is the unrecoverable portion of HST. For example, using a recent \$20 million purchase by the city, the unrecoverable HST will equal \$350,000.

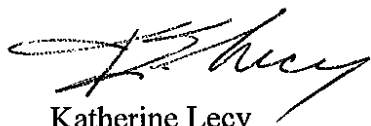
Financial Impact

In the near term , it will take time for the price of goods to decrease due to the removal of tax cascading of the embedded PST. Operating expenses will have an unfavourable estimated annual increase of \$0.2M . Based on a \$65M annual spend on capital, the estimated cost due to the unrecoverable HST is \$0.8M.

Over time, the price of goods is expected to decrease; and combined with the 75% rebate of the provincial portion of the HST, operating and capital programs will be neutral.

Conclusion

For 2010, the City should strategically accelerate purchases prior to the July 1, 2010 implementation of HST for goods and services currently on GST only. Goods that currently attract both PST & GST should be delayed wherever possible until after the HST implementation to take advantage of the 75% rebate of the provincial portion of the HST.



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Table 4: List of Goods and Services for which the Tax Rate will be Affected By Harmonization (does not include the pass through of business cost savings)

↔ = no change
 ↑ = increase in tax rate
 ↓ = decrease in tax rate

| Expenditure Category | | ON | BC | |
|------------------------------|----------------------------|--|--|---|
| Goods | Food | Basic Groceries | ↔ | ↔ |
| | | Prepared foods purchased at stores | ↔ | ↑ |
| | | Restaurant Food | ↔ | ↑ |
| | Energy | Natural Gas | ↑ | ↔ |
| | | Gasoline | ↑ | ↔ |
| | | Fuel Oil and Other fuels | ↑ | ↔ |
| | | Water | ↔ | ↔ |
| | Goods ex. Food and Energy | Clothing/footwear and accessories | ↔ | ↔ |
| | | Children's clothing and footwear | ↔ | ↔ |
| | | Household appliances | ↔ | ↔ |
| | | Other household furnishings and equipment | ↔ | ↔ |
| | | Recreational Equipment | ↔ | ↔ |
| | | Autos/recreational vehicles | ↔ | ↔ |
| | | Healthcare goods | ↔ | ↔ |
| Personal Care supplies | | ↔ | ↔ | |
| Tobacco and Tobacco products | | ↑ | ↔ | |
| Alcohol | | ↔ | ↔ | |
| Services | Shelter/ Office Services | Rent/mortgage interest costs/insurance | ↔ | ↔ |
| | | Maintenance and Repair | ↔ | ↔ |
| | Financial Services | Credit Application/Account Fees | ↔ | ↔ |
| | | Purchase/Selling of Investments | ↔ | ↔ |
| | | Portfolio Management Fees | ↑ | ↑ |
| | | Advisory Fees | ↑ | ↑ |
| | | Mergers and Acquisition Fees | ↑ | ↑ |
| | | Fees related to RRSPs, RRIFs, RESPs, TFSA's | ↑ | ↑ |
| | Other Non-Shelter Services | Telephone and Cable | ↔ | ↑ |
| | | Internet Access Fees | ↑ | ↔ |
| | | Postal Services | ↔ | ↔ |
| | | Child care Services | ↔ | ↔ |
| | | Other (cleaning, landscaping etc) | ↑ | ↑ |
| | | Services related to installation of household equipment and furnishings | ↔ | ↔ |
| | | Health care and Education Services | ↔ | ↔ |
| | | Personal Care Services (eg. hair cuts, manicures/pedicures, and facials) | ↑ | ↑ |
| | | Recreational Services | ↑ | ↑ |
| | | Admission Charges | ↓ | ↔ |
| | | Professional Services | ↑ | ↑ |
| | | Transport Services | Registration, drivers licences, and auto insurance | ↔ |
| Taxis | ↑ | | ↑ | |
| Other Public transportation | ↔ | | ↔ | |

Source: TD Economics, produced with information provided by Canada Revenue Agency, the Ontario Ministry of Finance and the B.C. Ministry of Finance
 Note the table is meant to capture the general direction of changes for each category, however there may be different treatment for certain goods within each categories.